No. 20390

IN THE
UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

A. BATES BUTLER, as Trustee of CONSTRUCTION MATERIALS CO.,

Appellant,

vs.

CITY OF TUCSON, et al.,

Appellees.

MARTIN CONSTRUCTION CO. and PACIFIC NATIONAL INSURANCE CO.,

Appellants,

vs.

BANK OF TUCSON, et al.,

Appellees.

On Appeal from The United States
District Court for the District of Arizona

ANSWERING BRIEF ON CROSS-APPEAL

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TABLE OF CONTENTS

	Page
Supplemental Statement of Case	2
Argument	4
Conclusion	26

TABLE OF AUTHORITIES CITED

Page

Cases:

Adamson v. Paonessa,
179 P. 880 9,12,13

American Surety Co. of New York
v. Empire Securities Co., et al,
197 P. 941 9,13

City of Tucson v. Superior Court
of Pima County, 406 P.2d 227,
2 Ariz. App. 25 9

Hall & Olsway v. Aetna Casualty
& Surety Co., 296 P. 162 23

Henningsen v. United States
Fidelity & Guaranty Co.,
208 U.S. 404 24

Hochevar v. Maryland Casualty
Co., CA 6, 114 F.2d 948 24

In Re Lynch's Estate,
377 P.2d 199, 92 Ariz. 354 9

Los Angeles Rock & Gravel Co.
v. Coast Construction Co., et al,
197 P. 941 9,13,15

McMorrey v. Superior Court,
201 P. 797 10

Peterson v. Flood,
326 P.2d 845, 84 Ariz. 256 9

Page

Cases (Cont.):

Prairie State National Bank
v. U.S., 164 U.S. 227 11,12

U.S. Fidelity and Guaranty Co.
v. City of Los Angeles,
203 P. 151 10,16

Webb v. Crane,
52 Ariz. 299, 80 P.2d 698 16

Statutes:

Arizona Revised Statutes

9-671 - 9-695 8,10
9-680 (e) 15
9-683 8
9-683 (e) 4
9-684 8
9-686 4,17
9-686 (h) 21
9-687 8
9-687 (a) 21
9-687 (e) 21
9-687 (f) 21,22

Text:

44 Am.Jur., Public Works, Sec. 59 19

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ANSWERING BRIEF ON CROSS-APPEAL

As in prior briefs, Appellant, A. BATES BUTLER, Trustee in Bankruptcy of Construction Materials Co., Bankrupt, is referred to as "Trustee"; CONSTRUCTION MATERIALS COMPANY, as "Construction";

CITY OF TUCSON, as "City"; THE BANK OF TUCSON, as "Bank"; MARTIN CONSTRUCTION COMPANY, as "Martin", and PACIFIC NATIONAL INSURANCE COMPANY, as "Pacific".

Most of the ultimate facts in the trial court were undisputed, and were made part of the record by a written Stipulation of Facts filed December 7, 1964, which stipulation is listed as document No. 28 in the Clerk's Certificate of Record on Appeal. This document is cited hereinafter as "Stipulation."

SUPPLEMENTAL STATEMENT OF CASE

As cross-appellants note, we are concerned on this cross-appeal with the disposition of certain improvement district bonds which were deposited in the registry of the Court by City and which were issued in relation to an

improvement district contract known as the Wilmot Improvement District Contract entered into by Construction and City March 26, 1963. On the same date, Construction assigned all the proceeds of the Wilmot Improvement District Contract to Bank (Assignment in evidence as Joint Exhibit 20) to secure the payment of Construction's promissory note to Bank (Joint Exhibit 19), and said assignment was accepted by City March 28, 1963 (Stipulation, page 5). At the time of the trial there was a balance due on said promissory note (Joint Exhibit 19) of $25,169.26, together with interest thereon at the rate of 6% from December 12, 1963 to date of entry of judgment herein (Finding of Fact No. 25 and Joint Exhibit 19). The question of the allowance of Bank's attorney's fees is the subject of Bank's separate

cross-appeal herein. The warrant and assessments on the Wilmot Improvement District Contract described and provided for in Arizona Revised Statutes, Sections 9-683 (e) and 9-686, were duly issued by the Superintendent of Streets of City on or before November 19, 1963 (Stipulation). Thereafter, on December 16, 1963, by Resolution No. 5664, the City approved the assessment and proceeding on the Wilmot Improvement District Contract (Stipulation, page 7). At trial, the issues as between Bank and Pacific were severed for later trial (Transcript of Proceedings of December 11, 1964).

ARGUMENT

As noted in the Supplemental Statement of Facts, at the trial of the main claims herein, the issues as between

Pacific and Bank were severed for later determination. The subject of the issues between Pacific and the Bank concerns defendant Bank's Exhibit A, which was designated as a part of Item No. 32 on the Clerk's Certificate of Record on Appeal, a purported surety bond. Among other things, said surety bond provides that:

> "The surety (Pacific) consents to the assignment of said improvement district contract and the proceeds thereof to the obligee (Bank) and recognizes the obligee's right to receive all payments whether in money, warrants, assessments or bonds, accruing on said improvement contract. The surety agrees that the obligee's right to receive such proceeds shall have priority ....",

thereby subrogating Pacific's rights to that of the Bank. Pacific resists this surety bond contending it was not effectively executed. Therefore, the questions of the respective rights of

Pacific and Bank were beyond the [illegible] determination. The subject of con- [illegible] between Pacific and the Bank con- cerns defendant Bank's Exhibit [illegible], which was designated as a part of Item No. 12 on the Clerk's Certificate of Record on Appeal; a purported surety bond. Among other things, said surety bond provides that:

> "The surety (Pacific) consents to the assignment of said improvement district contract and the moneys payable thereunder to the obligee (Bank) and recognizes the obligee's right to receive all payments (whether in money, warrants, assessments or bonds) according to said instrument contract. The surety agrees that the obligee's right to such payments shall have priority [illegible]"

Pacific subsequently [illegible] that of the Bank. Pacific contends this surety bond [illegible] it was not [illegible] [illegible], however, [illegible] of the [illegible] [illegible]

Pacific and surety as to the bonds were actually severed at date of trial, however, the District Court apparently proceeded as on summary judgment and concluded that as a matter of law and irrespective of the proof of the execution of the purported surety bond by Pacific, that the Bank was entitled to priority as to the bonds. Therefore, as between Bank and surety, the issues cannot now be resolved adversely to the Bank until a later fact determination is made as to whether or not the surety bond and the subordination contained in it was executed by Pacific. The Court can, however, as did the District Court, hold as a matter of law, and irrespective of the subordination agreement contained in the bond, that the Bank is entitled to priority. Therefore, this cross-appellee will proceed on that basis as regards

the cross-appeal of Pacific.

Turning then to the cross-appeals of Pacific and Martin, we find that every contention raised by cross-appellants Pacific and Martin has been previously raised and decided in cases involving the relative rights of sureties and assignees in cases construing improvement district contracts, warrants, assessments and bonds, which are nearly identical to those involved in the present case and arising under Improvement District Statutes, also nearly identical. These issues have been uniformly and completely answered in favor of the cross-appellee Bank, as the assignee.

The Arizona Improvement District Statutes under which the Wilmot Improvement District Contract was let, and the warrant, assessments, and bonds in question issued, so far as pertinent, are

Arizona Revised Statutes, Section 9-671 through 9-695, inclusive, which statutes were adopted from the statutes of the State of California in force at the time of adoption, 1912. (Historical note, Secs. 9-671 through 9-695, inclusive, Arizona Revised Statutes of 1956, and, in particular, the more pertinent portions thereof, A.R.S. 9-683, 9-684, 9-686 and 9-687.)

The specific questions raised on this appeal, that is, the relative rights and priorities of an assignee of the proceeds of an improvement district contract who has served notice of said assignment upon the public body, and the rights of the surety who has been compelled to pay labor and material claims has never been passed upon by the Supreme Court of the State of Arizona. Therefore, we must look to the

decisions of the highest Court of the state from which we adopted the statutes, which decisions will "be most persuasive" - if not conclusive. City of Tucson v. Superior Court of Pima County, 406 P.2d 227, 2 Ariz. App. 25; Peterson v. Flood, 326 P.2d 845, 84 Ariz. 256, In Re Lynch's Estate, 377 P.2d 199, 92 Ariz. 354.

Looking then to the cases of the State of California, from which, as above noted, we adopted the statutes in question, we find that the questions raised by the cross-appellants Martin and Pacific on their cross-appeals have been repeatedly raised and have been repeatedly stricken down in favor of the assignee Bank. Adamson v. Paonessa, 179 P. 880; Los Angeles Rock & Gravel Co. v. Coast Construction Co., et al and American Surety Co. of New York v.

Empire Securities Co., et al, 197 P. 941; McMorrey v. Superior Court, 201 P. 797; U. S. Fidelity and Guaranty Co. v. City of Los Angeles, 203 P. 151

In the Paonessa case, Paonessa contracted with the City of Colten, California, and gave a surety bond on which National Surety was the surety, all pursuant to the California Improvement District Statutes of 1911 which, as above noted, were adopted by the State of Arizona as Arizona Revised Statutes, Sec. 9-671 through 695, inclusive. Paonessa subsequently assigned the contract proceeds to one Lloyd, who served notice of the assignment upon the City of Colten. Thereafter, Paonessa completed the work but left unpaid material and labor claims which were paid by National Surety. When Lloyd, as assignee of Paonessa, and the surety company

both demanded the improvement district bonds issued by the City of Colten, the surety and assignee were interpleaded by the City. The assignee, of course, claimed under his collateral assignment and the surety by equitable subrogation. The Court held that laborers and materialmen had no "claims against the work" nor any rights in the contract proceeds (Bonds) but that their sole recourse was against the surety bond given by the contractor. Therefore, the laborers and materialmen having no claims against the bonds to which the surety could become subrogated, as between the surety, the laborers and materialmen and the assignee, the assignee takes priority. The Court specifically distinguished the case upon which cross-appellants Pacific and Martin rely. Prairie State National Bank v. U.S., 164 U.S. 227,

noting that in the Prairie State National Bank case and the others following that line of reasoning, the facts, although basically the same as in the Paonessa case (and the instant case) were critically different, in that, in those cases a fund was reserved for the benefit of laborers and materialmen creating a fund against which laborers and materialmen might have a claim and to whose rights the surety might be subrogated. However, under the California Statutes, and also under the Arizona Statutes, there is no such fund against which the laborers and materialmen have a right, they solely having a claim against the surety bond and, therefore, there is no claim against the contract proceeds to which the surety can become subrogated. Therefore, the assignee must prevail over the surety.

The cases of Los Angeles Rock & Gravel Co. v. Coast Construction Co. and American Surety Co. of New York v. Empire Securities Co., 197 P. 941, two consolidated cases, follow the Adamson v. Paonessa case very closely. Again the same claims as in the instant case were raised by the surety as against the assignee of the proceeds of a public works contract. The cases again held that the laborers' and materialmen's rights were solely against the surety bond and that they had no claim against the work or against the proceeds of the contract and thereby also striking down the surety's claim to subrogation or exoneration. The surety in these cases contended, as do cross-appellants herein, that because the contract contained a clause which provided that the contractor was to turn over the work free and clear

of all claims of laborers and materialmen, upon the contractor failing to pay all material and labor claims, the assignee had no right to the contract proceeds, as they were not due, and therefore the laborers, materialmen and the surety could reach the funds. The Court stated that it would not consider the question of the validity of the clause, which was inserted in the contract without statutory authority, and they held that:

> "...the clause in question merely expresses the general legal duty on the part of the contractor to pay all materialmen and laborers. It imposes no additional burden on the contractor but simply reduces to writing the nature of the legal duty in regard to such matters assumed by the contractor and which would exist whether in writing or not."

There is, likewise, no statutory authority in Arizona for the contract provision in question and to the contrary it

is to be noted that the Arizona Statutes, adopted, as noted, from the California Statutes, and in particular, A.R.S. 9-680 (e) provides:

> "Upon completion of the work, the contractor shall be entitled to the issuance and delivery of the assessments as provided in this article."

thereby giving the contractor, as in the Los Angeles Rock & Gravel Co. v. Coast Construction Company case (supra), an absolute right to the issuance and delivery of the warrant and assessment upon completion of the work. Again, there is no fund reserved for the protection of laborers and materialmen to whose rights the surety might become subrogated.

In any event, the question of whether laborers and materialmen could have a "claim" or "demand" against the work, has been answered in the negative

by the Supreme Court of the State of Arizona. Webb v. Crane, 52 Ariz. 299, 80 P.2d 698 laid the question to rest when it held that laborers and materialmen have no lien rights (the only claim or demand they could have) on any public building and, therefore, neither could any such claim (lien) exist against a public improvement, street or any other public property.

The third pertinent case, United States Fidelity & Guaranty Co. v. The City of Los Angeles (supra) involves an uncannily identical fact situation to the instant case and was one in which the surety company raised identical claims to those raised by Pacific and Martin here. These contentions were all stricken down and the assignee (here, the Bank) was given priority to the proceeds of the construction contract, the

warrant, the assessment and the bonds.

The Court again stated:

> "There is no provision which gives any such claimant (materialmen and laborers) any right or lien, equitable or otherwise upon money or bonds coming to the contractor."
>
> And,
>
> "Where the contractor has assigned before the surety sues to require the application of the debt the surety cannot succeed as against the assignee."

The Court, in that case pointed out that the statutes in question even contemplated that the warrant and assessment would be assigned. So do the Arizona Revised Statutes, as Sec. 9-686 provides that the warrant signed by the Superintendent of Streets and countersigned by the Mayor, shall state as follows:

> "...do authorize and empower (name of contractor) his agents or <u>assigns</u> to demand and receive the several assessments upon the assessment hereto attached and this shall be his warrant for the same." (emphasis supplied)

The foregoing cases firmly establish, that under the fact situation in the instant case, the rights of the assignee are superior to those of laborers, materialmen or sureties to the contract proceeds.

The foregoing should be sufficient to dispose of the contentions of Martin and Pacific. However, there is a further reason why cross-appellants' arguments are not valid. The argument that the contract required the work to be delivered free and discharge of claims for laborers and materialmen is not only invalid because the work <u>was</u> delivered free of such claims as above noted, but for the further reason that assuming, arguendo, there was any such claim, the contract in question was between Construction and City and it is without question that City could waive that

contract provision as against Construction or Martin. 44 Am.Jur., Public Works, Sec. 59, et seq, notes that, in the absence of any controlling legislative provisions, where the retention by public authorities of monies due to contractor until laborers and materialmen of the contractor have been paid is a matter of contract between the contractor and the public body (as it was here), it is clear that the public authorities may waive the provision and pay the contractor without requiring proof that he paid his laborers and materialmen, and without incurring any liability to them. In this case, if there was any such right, it is clear that it was waived, for the warrant and assessment was delivered to the contractor, Construction, or its assignees. (Stipulation, page 5) Further, the

bonds were executed and issued (Stipulation, page 7) and deposited in the registry of the Court. Obviously then, the City, if it had any right to retain the warrant, assessment or bonds, had waived such right, and by such waiver does not incur any liability to Pacific or Martin. In fact, the City has expressly done so in its answer to the complaint and cross-claims herein and in its answering brief on Trustee's appeal, as it has taken the position of a mere stakeholder, claiming no interest itself in the bonds in question or any right to retain them.

Further and conclusively, Martin and Pacific are precluded by statute from now claiming that the Wilmot Improvement District Contract was not fully completed according to its terms, or to claim that the City had a right

to retain the bonds.

A.R.S. Secs. 9-686 (h) and 9-687 (a) provide that the warrant and assessment shall be recorded in the office of the Superintendent and that after they are recorded they shall be delivered to the contractor as was done in the instant case (Stipulation, page 5). Thereupon, pursuant to A.R.S. Sec. 9-687 (e), the governing body holds a hearing to pass upon the assessment and proceedings. At which time, pursuant to A.R.S. Sec. 9-687 (f):

> "The owners, contractors and all other persons directly interested in the work or in the assessments, who have any objection to the legality of the assessment or to any of the previous proceedings connected therewith, or <u>who claim that the work has not been performed according to the contract</u> may, prior to the time fixed for hearing, file a written notice briefly specifying the grounds of their objection." (emphasis supplied)

A.R.S., 9-687 (f) further provides that:

> "The decision of the governing body shall be final and conclusive upon all persons entitled to object as to all irregularities, errors, informalities, and irregularities which the governing party might have remedied or voided at any time during the progress of the proceedings."

Nowhere does it appear that Pacific or Martin objected and by Resolution No. 5664, December 16, 1963 (Joint Exhibit No. 23), the City of Tucson approved the assessment and previous proceedings for the Wilmot Improvement District Contract (Stipulation, page 7), thereby forever precluding any claim by Pacific or Martin that the work was not completed according to the contract.

In a brief closing comment on the cases cited by the cross-appellants in support of their position, it is again

important to note that in each such case there was a specific percentage of the contract retained as a fund for the protection of laborers and materialmen, to which the surety can become subrogated. Where there is no such retained fund or if there be some retainage, but there be excess funds above such percentage retention, the assignee of the contractor is entitled to priority thereto over the claims of the laborers, materialmen or the surety as to the contract proceeds or the excess funds over the amounts so specifically retained. Hall & Olsway v. Aetna Casualty & Surety Co., 296 P. 162. Further each of the three cases relied on by cross-appellants were U. S. Government Contracts, each retaining a percentage fund for the protection of laborers and materialmen. In fact, in one case

(Henningsen v. United States Fidelity & Guaranty Co., 208 U.S. 404) the assignee's assignment was apparently void under the federal code and the court was merely dealing with bare equities, not with a legal, written, accepted assignment. Also, the Hochevar v. Maryland Co., CA 6, 114 F.2d 948 case relied on by cross-appellants, not only had a specific 15% retention fund, but the contractor was required to consent in writing and in advance to the application of the fund to the claims of laborers and materialmen. The case did not hold that the surety had a right to the retainage, but merely that under the consent to apply the funds it had a right to such application.

One further consideration of cross-appellant Pacific's position is in order. In each of said cross-appellant's cases,

the surety had paid the claims of laborers or materialmen or completed the work, thereby giving rise to whatever rights it might have while in this case there is no evidence of any payment by surety to anyone and in fact, Pacific was disputing Martin's claim to recover.

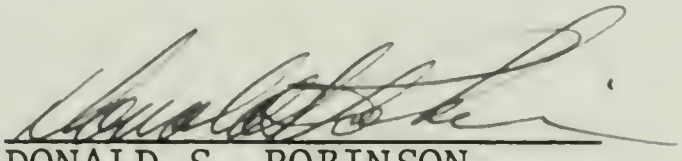
In any event, as above noted, the truly controlling factor is that under the pertinent statues and the Improvement District Contract, Martin has no claim or right to the bonds and there was no fund reserved for the protection of the laborers and materialmen to which the surety could become subrogated, therefore, the principles set forth in cross-appellant's cases are simply not applicable to the instant fact situation, and the cases above cited by Bank herein must be followed.

CONCLUSION

Arizona adopted the Improvement District Statutes under which the instant case arose from California and the California cases have very clearly and repeatedly refuted and stricken down every contention raised by cross-appellants Pacific and Martin in the instant case and have upheld the rights of the assignee (in this case, Bank) as against them. Also, the cross-appellants are precluded by statute from now raising any claims that the contract was not completed according to its terms. Therefore, it is clear that, as between cross-appellee Bank, as the assignee of Construction whose assignment was duly served upon the City and accepted, and Pacific and Martin as surety and materialmen respectively, the Bank's claim is prior to that of

Pacific or Martin, as their claim must rest solely upon the equitable assignment which was executed, served and accepted subsequent to the assignment of the Bank. Therefore, the judgment of the District Court that the Bank has, to the extent of its unpaid note, a prior right in the improvement district bonds to that of Pacific and Martin, must be affirmed.

Respectfully submitted,



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